
Real Estate Mortgage Lending Program

Examination Objectives

To determine if policies, practices, procedures, and internal controls regarding real estate loans are adequate.

To assess management's conformance with established guidelines.

To evaluate the real estate loan portfolio for credit quality, collectibility, and sufficiency of loan collateral.

To assess the scope and adequacy of the audit function.

To ensure compliance with applicable laws and regulations.

To identify the strengths of the real estate lending function.

To initiate corrective action when policies, practices, procedures, objectives, or internal controls are deficient or when violations of law or regulations have been noted.

Examination Procedures

Level I

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1. Review the real estate lending policies and procedures for adequacy, given the volume and type of lending activity, and for conformity with 12 CFR § 563.100-101. Specifically, the review should focus on whether the policies and procedures address and are adequate with regard to:
 - a. Geographic limits;
 - b. Acceptable types of properties;
 - c. Lending authority for committee and individual officers;
 - d. Minimum standards for documentation, amount, and frequency of financial information on borrowers for different types of mortgage loans, especially "low-doc" loans;
 - e. Minimum standards for qualification of borrowers for various loan products, such as ARMs and teaser-rate loans;

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- f. Maximum loan-to-value ratios or loan-to-purchase price ratios;
- g. Maximum maturities;
- h. Amortization requirements;
- i. Procedures for reviewing real estate loan applications;
- j. Internal controls regarding the mortgage documents and the preparation, posting, and reconciliation of loan records;
- k. Collection and charge-off procedures;
- l. Mortgage blanket hazard insurance;
- m. Policy review and approval by the board of directors at least annually; and
- n. Compatibility with the business plan and current market conditions.

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2. In conjunction with the examiner(s) performing the audit programs (Thrift Activities Regulatory Handbook Sections 350, External Audit, and 355, Internal Audit), review the scope and depth of the work performed by internal and external auditors in the real estate lending area. Obtain a list of any deficiencies or exceptions contained in the latest review and determine if the association made the appropriate corrections.
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3. Obtain and review the following information, as it pertains to real estate lending, from the examiner(s) responsible for Thrift Activities Regulatory Handbook Section 210, Lending Risk Assessment:
- a. Lending, appraisal, and collection policies and procedures;
 - b. Past-due loans;
 - c. Loans in a nonaccrual status;
 - d. Loans for which interest is not being collected in accordance with the terms of the loan;

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- e. Loans whose terms have been modified by a reduction of interest rate or principal payment, by a deferral of interest or principal, or by other restructuring of repayment terms;
- f. Loan participations purchased and sold;
- g. Loans sold in full since the previous examination;
- h. Loans considered “problem loans” by management;
- i. Loan commitments and contingent liabilities;
- j. Extensions of credit to employees, officers, directors, principal shareholders, and their interests;
- k. Extensions of credit to officers, directors, and principal shareholders of other institutions;
- l. Current interest-rate structure and loan pricing;
- m. Officers’ current lending authority;
- n. Pertinent reports furnished to the board of directors and the loan committee; and
- o. Underwriting and collection experience of “low-doc” loans.

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4. Review the preceding report of examination and all real estate lending-related exceptions noted and determine if the association made the appropriate corrections.
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5. Summarize findings, obtain management responses, and update programs and the continuing examination file (CEF) with any information that will facilitate future examinations. File exception sheets in the general file.
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6. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.
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Level II

7. Using an appropriate sampling technique, select loans for review. (For details on sampling, refer to Section 209 of the Thrift Activities Regulatory Handbook.)
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8. Transfer relevant information from the trial balance to the Thrift Activities Loan Review line sheets, where appropriate, including indication of any past-due, nonaccrual, or problem status.
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9. Prepare Thrift Activities Loan Review line sheets for any loans not in the sample that require in-depth review. Types of loans to be considered in this portion of the review include:
- a. Loans granted and participations purchased since the previous examination;
 - b. Loans sold in full since the preceding examination;
 - c. Multiple loans to the same borrower or related group of borrowers, particularly those that represent a concentration of credit;
 - d. Loan commitments and other contingent liabilities;
 - e. Syndication loans;
 - f. Loans to affiliated persons; and
 - g. "Low-doc" loans.
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10. Obtain the institution's credit or loan files on the loans selected for review. While

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analyzing the loan, test for compliance with the institution's established policies, procedures, and controls. The following considerations may be beneficial during the loan review process:

- a. The credit quality of the loan. Consider the adequacy of primary and secondary sources of repayment, including the value, quality, and liquidity of the security property and other collateral support. Financial statements from the current and previous periods, as well as loan officers' memoranda and correspondence, should also be considered to identify unfavorable or adverse trends.
- b. The adequacy of any secondary support afforded by guarantors and endorsers.
- c. Compliance with established policy and procedures.
- d. Compliance with applicable laws and regulations.
- e. The lack of current and complete financial information or that the information obtained was not reviewed, analyzed, and evaluated.
- f. Deficient collateral documentation.
- g. Compliance with provisions of any loan agreements.
- h. Adherence of the original amount of the loan to the lending officer's authority.
- i. Adherence of the interest rate charged and terms to the established parameter of the interest-rate schedule.
- j. The appearance of preferential treatment or actual or potential conflicts of interest on loans to affiliated persons.
- k. Excessive debt ratios, i.e., high monthly mortgage payments relative to borrower income.
- l. A loan advertising program indicating that the institution relies on collateral only or predominantly rather than the borrower's ability to repay.

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11. Ensure that the Objectives of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective

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measures, on the appropriate work papers and report pages.

Level III

12. Reconcile the real estate loan trial balance to the general ledger and review reconciling items for reasonableness.
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13. For participation loans purchased and sold and loans sold in full since the preceding examination:
- a. Determine whether the institution is aware of both the lead lender's and the purchasing association's responsibilities relating to loan participations sold or purchased.
 - b. Test participation certificates and records and determine that the parties share in the risks and contractual payments on a pro rata basis.
 - c. Determine whether the books and records properly reflect the institution's liability.
 - d. Determine whether the institution exercises controls and procedures over loans sold and loans serviced for others similar to those it exercises for loans in its own portfolio.
 - e. Investigate any loans or participations sold immediately prior to the examination to determine whether any were sold to avoid criticism during the examination.
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14. For FHA-insured loans and VA-guaranteed loans:
- a. Determine that a valid certificate of insurance or guaranty is on file by reviewing management's procedures to obtain such insurance or guaranty or by test checking a representative sample of such loans.
 - b. Determine that required delinquency reports are being submitted.
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15. For discounted or “teaser” ARMs:
- a. Determine if the institution’s current pricing structure or policy is sufficient to recover the institution’s operating expenses, funding cost, and risk premium. If not, determine the soundness of management’s strategy, such that: deeply discounted ARMs, even in periods of stable or falling interest rates, may not reach profitability until at least two or three repricings occur; any interest-rate movement above the yearly interest-rate cap must be absorbed by the institution; and refinancing existing ARMs at lower rates offered on new ARMs reduces the opportunity to recoup initial losses in subsequent repricings.
 - b. Determine if the institution’s lending policies and procedures and underwriting guidelines adequately address the increased default risk by qualifying borrowers’ at or near fully indexed rates.

Examiner’s Summary, Recommendations, and Comments

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